Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Briggs | Analyst: Jeff Garnier | Bill Number: AB 76XX

Related Bills: See Legislative History | Telephone: 845-5332 | Introduced Date: June 19, 2001

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Hot Water Recirculating System Credit

SUMMARY

This bill would provide a credit equal to 50% of the costs of a hot water recirculating system.

PURPOSE OF THE BILL

The author's staff has indicated the purpose of the bill is to encourage water and energy conservation in the state.

EFFECTIVE/OPERATIVE DATE

As a tax levy this bill would be effective upon enactment and operative for taxable years beginning on or after January 1, 2001 and before January 1, 2006.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to resolve the issues discussed in the "Implementation Concerns" below.

ANALYSIS

FEDERAL/STATE LAW

Federal and state tax laws contain various credits to encourage certain taxpayer behavior. Several of these credits encourage conservation or preservation, such as the state rice straw credit and natural heritage preservation credit.

THIS BILL

For taxable years beginning on or after January 1, 2001 and before January 1, 2006, this bill would create a credit for all taxpayers equal to 50% of the costs of a hot water recirculating system made operational with a qualified plumbing fixture. The system must be installed as part of new construction or renovation or remodel. A "hot water recirculating system" would mean a system of pipes with a motor driven pump that recirculates water between a water heater and hot water faucets.

Board Position:			Department Director	Date
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A recirculating system enables substantially all of the cold water in the hot water pipes to be continually returned to the water heater and reheated before the hot water faucet is turned on.

A “qualified plumbing fixture” would include:

- Low-flow shower heads (maximum flow of 2.5 gallons per minute).
- Hot water faucets with more than 10 feet of pipe connecting the faucets to the hot water heater.

“New construction" would be defined as the:

- Construction of a new structure;
- Addition to a preexisting structure; or
- Renovation or remodeling of a preexisting structure, but only with respect to the portion of the preexisting structure being renovated or remodeled.

In the case of a new structure that has never been occupied for its intended purpose, the bill provides that the owner of the property, on and after the date the hot water recirculating system was installed, may be allowed the credit.

No deduction would be allowed for any cost for which the credit is allowed.

If the credit exceeds the net tax or tax, the bill would provide that any unused credit may be carried over for seven years.

To the extent that information is available, this bill would require the FTB to annually report to the Legislature regarding the utilization of this credit.

IMPLEMENTATION CONSIDERATIONS

It is unclear if the hot water pipe typically installed in structures would be part of the hot water recirculation system.

In order to avoid confusion, a threshold description or amount is needed for the terms "renovated" and "remodeled."

In the case of a structure that has not been occupied for its intended purpose, the bill provides that the owner of the property on and after the date the hot water recirculating system was installed may be allowed the credit. The bill does not specify how long "after" the taxpayer must hold the property to qualify for the credit. The term "after" may be confusing to subsequent buyers of the property.

BACKGROUND

The basic principle of the hot and cold water system in common use today is to keep hot water in the pipes near the faucets where it is used. This eliminates waste by eliminating the need to run the cold water out of the hot water pipes and down the drain.

The California Energy Commission (CEC) in its "Residential Manual for Compliance with the 1998 Energy Standards" requires that most hot water recirculation systems be counted as an energy user, not as an energy saver. In determining if a residential structure meets the minimum energy efficiency standards, hot water recirculating systems that do not have a demand control device or both a time and a temperature control device are assigned a penalty.

OTHER STATES' INFORMATION

Florida and Illinois: Do not have any credits based on energy conservation.

Massachusetts: Currently has an energy credit that is equal to 15% of the net expenditures or $1,000, whichever is less.

Michigan: Does not allow an energy-related credit, but exempts the value of energy conservation devices from the local property tax.

New York: For personal income taxpayers only, *New York* allows a credit for solar generating equipment equal to 25% of certain solar generating expenditures. The credit is capped at $3,700 per system.

The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

If the implementation concerns are resolved, this bill would not significantly increase the department's cost

ECONOMIC IMPACT

Revenue Estimate

Based on the data and assumptions below, revenue losses are estimated as follows:

Estimated Revenue Impact			
Taxable/Income Years Beginning On or After January 1, 2001			
Enactment Assumed After June 30, 2001			
Fiscal Years			
(In Millions)			
	2001-2	2002-3	2003-4
Hot Water Recirculation Systems Credit	-$13	-$17	-$22

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The impact of this bill would depend upon the number and type of taxpayers installing these systems, the average credit claimed, and the average credit applied against tax liabilities.

It is projected that in California for 2001, approximately 115,000 single-family residences will be renovated or remodeled with an additional 115,000 new homes being started. Of these, 12,000 single-family home renovations are expected to qualify for this credit at an average system cost of $350 (this system would not include the installation of a third pipe.) It is also anticipated that 12,000 new homes will qualify the purchaser for this credit. Systems installed in new homes are more apt to include a third pipe, dedicated to the return of tepid water to the water heater, since the installation of the pipe does not require extensive renovation as it would in existing homes. The systems installed in new homes are projected to cost approximately $800, an average cost of various system types. The credit would be limited to 50 percent of the cost of the system.

The number of multifamily residences projected to be built in California in 2001 is 43,234. It is expected that approximately 4,000 of these residences will have systems installed at an average cost of $800 per system. It is also expected that an additional 4,000 retrofit systems will be installed in multifamily residence renovations or remodels at an average cost of $350 each. Five units is the projected number of units per each multifamily residence. The credit would be limited to 50 percent of the cost of the system.

Applications for industrial and commercial usages of hot water recirculation systems include hotels, hospitals, hair salons, ships, and machinery and tool manufacturers. The commercial and industrial systems can employ larger, more sophisticated systems and/or a vast number of systems for one business. Data pertaining to the cost, current usage, and potential growth rates for the industrial and commercial systems is not readily available as it is for residential applications. Due to the number and expense of these types of systems, the projected revenue loss was conservatively estimated at 50 percent of the total residential revenue loss.

The projected incentive effect for purchases of hot water recirculation systems ranges from 10% in 2001 to 15% in 2004, based on a “50 percent of cost” credit. Less than one percent of new California homes are now equipped with hot water recirculation systems.

One-half of the cost associated with these systems would not be deductible under the proposal. Therefore, an offset of approximately $500,000 was made in 2001 for amounts paid for these systems that would have been allowable as income tax deductions if not for this proposal.

For purposes of claiming the proposed credit, new homebuilders would be eligible to claim the credit in lieu of new homebuyers.

Estimates were developed in coordination with building industry experts at the California Building Industry Association, water usage experts at various California irrigation districts, representatives of hot water recirculation systems manufacturers, and information from various government agencies.

ARGUMENTS/POLICY CONCERNS

The credit would be allowed for hot water recirculation system expenses paid or incurred with respect to property located either inside or outside California.

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